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Supreme Court of the United States

OCTOBER TERM, 1951.

No. 547.

AL HOROWITZ, *et al.*,

Petitioners,

—against—

JACOB J. KAPLAN, *et al.*, Trustees,

Respondents.

PETITION FOR WRIT OF CERTIORARI.

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INDEX.

Subject Matter.

PAGE

Opinions Below 1

Jurisdiction 1

Statutes Involved 2

Questions Presented 2

Statement 2

A. Introduction 3

B. The Provisions of the Plan 4

C. Genesis of the Plan 6

D. Confirmation of Plan 9

Reason for Granting the Writ 10

Conclusion 18

Appendix 19

Cases Cited.

Brockett v. Winkle Terra Cotta Co., 81 F. 2d 949 (8th Cir. 1936) 13

Brown v. Gerdes, 321 U. S. 178 (1944) 16

Case v. Los Angeles Lumber Products Co., 308 U. S. 106 (1939) 10, 11, 12, 13, 14

Chase v. Austrian, 189 F. 2d 555 (4th Cir. 1951), cert. denied 341 U. S. 952 (1951) 17

PAGE

Consolidated Rock Products Co. v. Du Bois, 312 U. S. 510 (1941) 11, 12

Dickinson Industrial Site v. Cowan, 309 U. S. 328 (1940) 16

Duggan v. Sansberry, 327 U. S. 499 (1946) 16

Ecker v. Western P. R. Co., 318 U. S. 448 (1943) 11

Fidelity Assurance Association v. Sims, 318 U. S. 608 (1943) 16

Finn v. Meighan, 325 U. S. 300 (1945) 16

Group of Institutional Investors v. Chicago, M., St. P. & P. R. Co., 318 U. S. 523 (1943) 11

Knight v. Wertheim & Co., 158 F. 2d 838 (2d Cir. 1947), cert. denied 331 U. S. 819 (1947) 14

Leiman v. Guttman, 336 U. S. 1 (1949) 16

Marine Harbor Properties, Inc. v. Manufacturers Trust Co., 317 U. S. 78 (1942) 11, 16

Morrison v. Burnette, 154 Fed. 617 (8th Cir. 1907) 15

Mosser v. Darrow, 341 U. S. 267 (1951) 16

New England Coal & Coke Co. v. Rutland R. Co., 143 F. 2d 179 (2d Cir. 1944) 17

Northern Pacific R. Co. v. Boyd, 228 U. S. 482 (1913) 10

Otis & Co. v. S.E.C., 323 U. S. 624 (1945) 11

Price v. Gurney, 324 U. S. 100 (1945) 16

In re Pure Penn Petroleum Co., 188 F. 2d 851 (2d Cir. 1951) 13

R.F.C. v. Denver & Rio Grande W. R. Co., 328 U. S. 495 (1946) 11

R.F.C. v. Kaplan, 185 F. 2d 791 (1st Cir. 1950) 8

PAGE

R.F.C. v. Prudence Securities Advisory Group, 311 U. S. 579 (1941) 16

Rogers v. Hill, 289 U. S. 582 (1933) 16

S.E.C. v. Central-Illinois Securities Corp., 338 U. S. 96, 130 (1949) 11

S.E.C. v. United States Realty & Improvement Co., 310 U. S. 434 (1940) 10

Sword S.S. Line v. Vendramis, 116 F. 2d 665 (2d Cir. 1940) 17

Vanston Bondholders Protective Committee v. Green, 329 U. S. 156 (1946) 16

In re Waern Building Corp., 145 F. 2d 584 (7th Cir. 1944) 13

In re Waltham Watch Co., 97 F. Supp. 189 (D. Mass. 1951) 1

Williams v. Austrian, 331 U. S. 642 (1947) 16

Woods v. City Nat. Bank & T. Co., 312 U. S. 262 (1941) .. 16

Young v. Higbee, 324 U. S. 204 (1945) 16

STATUTES.

Bankruptcy Act

Section 172, 11 U. S. C. § 572 19

Section 173, 11 U. S. C. § 573 19

Section 174, 11 U. S. C. § 574 19

Section 221, 11 U. S. C. § 621 20

TEXTS AND RECORDS.

6 Collier on Bankruptcy, 14th Ed., par. 11.06 12

H. R. Rep. No. 1409, 75th Cong., 1st Sess. 47 (1937) 16

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Respondents.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The petitioners respectfully show:

OPINIONS BELOW.

The opinion of the Court of Appeals (266-284) is not yet reported. The opinions of the District Court approving the plan of reorganization appear at 130-132; 225-240 and are unreported. The District Court wrote no opinion on confirmation of the plan, but did write an opinion (25-40) with its direction that the plan be submitted for consents to interested parties, reported at 97 F. Supp. 189 (D. Mass. 1951).

JURISDICTION.

The judgment of the Court of Appeals for the First Circuit was entered on November 29, 1951. Jurisdiction of this Court is invoked under Title 28, Section 1254(1).

STATUTES INVOLVED.

The pertinent statutory provisions are printed in the Appendix, pages 19-20, *infra*.

QUESTIONS PRESENTED.

1. In a reorganization of a solvent corporation under Chapter X of the Bankruptcy Act, where the equity is to be reallocated from the common stockholders to outsiders, must the dilution be compensated by a tangible equivalence in money or money's worth rather than by expected future managerial services, when the avowed "worth to the debtor" of the services "is essentially a matter of forecast based on imponderable factors"?

2. Whether the fairness and equitableness of a plan of reorganization must be determined as of the dates respectively when it is approved and confirmed and not as of the earlier date when it was originally formulated?

3. Whether a reorganization proceeding should be dismissed when creditors are fully satisfied and no alteration in the rights of security holders is being made except insofar as a gift of part of the equity of the common stockholders is being made to management?

STATEMENT.

The petitioners are stockholders of Waltham Watch Company and a protective committee for stockholders.[1] They appealed to the Court of Appeals for the First Circuit from an order of the District Court for the District of Massachu-

[1] The term "stockholders" is used in lieu of voting trust certificate holder. In the first reorganization a voting trust had been created. Under the present plan the voting trust is amended so that it will terminate one year after confirmation.

In the Court of Appeals a motion was made to dismiss the appeal on the ground that the appellant stockholders were not holders and on the ground that the committee had no standing. This motion was denied (265).

setts confirming a plan of reorganization under Chapter X of the Bankruptcy Act. The Court of Appeals affirmed the order of the District Court.

A. Introduction.

The plan of reorganization which has been confirmed is unique in the annals of bankruptcy reorganization. The debtor is absolutely solvent in every sense, bankruptcy and equity. There are no creditors' rights to be altered; creditors are receiving or have received full payment as due. No rights of existing stockholders are to be adjusted, inter sese.

The sole and simple purpose and result of the plan confirmed below is to grant to admitted "outsiders," so termed by the Court of Appeals, a working control share of the stockholders' equity. This control is taken from its present owners and reallocated to such outsiders. This grant is made not in exchange for money or tangible money's worth but in gratitude for assistance of the outsiders in promulgating the present plan, albeit it was obsoleted financially at the date of confirmation, and for the presumed competence of the outsiders as corporate managers.

In short, viewed as it must be as of the date of confirmation, the plan invests outsiders with all the fruits of the reorganization.

From the reorganization these outsiders are reaping, in addition to large salaries and profit-sharing arrangements, the following specific benefits:

> (a) $800,000 to $1,200,000 in current market benefits through a grant of 20% (400,000) of the common stock of the company at 25¢ per share, although the book value of the shares is more than $2.56 and the market value is between $2.00 and $3.00 and although a same number of shares is being offered to present stockholders at $1.00 per share.
>
> (b) An option for 4½ years to purchase 350,000 shares of common stock at 95% of the market value of the stock, which if exercised will give them together

with the bargain shares mentioned above, a total of 31.9% of the outstanding common stock.

It is the petitioners' contention that such a dilution of the stockholders' equity in favor of outsiders is neither fair nor equitable as matter of law and that the courts below have misapplied the legal standards of Chapter X.

B. The Provisions of the Plan.

Waltham Watch Company is admittedly solvent. The sole outstanding capital assets consists of 1,200,000 shares of common stock worth $2.56 per share on appraised book value, after full effect to the plan, and $2.00 at market value on the date of the confirmation of the plan. The sole effect of the plan is to dilute and redistribute the shares of the present shareholders in favor of the Messrs. Sachs through the following provisions:

(1) 400,000 shares of new stock are to be sold to present stockholders at $1.00 per share (253).

(2) 400,000 shares of new stock are to be sold to the Messrs. Gilbert and Teviah Sachs at 25 cents per share (254).[2]

(3) The Messrs. Sachs are to receive a 4½-year option to purchase 350,000 additional shares at 95% of the market value at the date the option is issued [3] (255).

As above stated, the net effect of the plan is that the Messrs. Sachs will end up with a minimum of 20% of the equity of Waltham Watch even if they do not exercise their

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[2] Of these 400,000 shares, 100,000 shares shall not be sold or voluntarily transferred for a period of six months after issue; 100,000 shares shall not be sold or voluntarily transferred for a period of one year after issue; 150,000 shares shall not be sold or voluntarily transferred for a period of two years after issue. No restrictions exist with respect to 50,000 shares (Plan 15).

[3] Mr. Teviah Sachs will have an option on 235,000 shares, Mr. Gilbert Sachs on 115,000 shares (255).

option.[4] If the option is exercised, they will own 31.9% of the equity.[5]

The diversion of values from the present stockholders to the Messrs. Sachs (apart from any effect of the option) amounts to more than $1,000,000 according to the January 23, 1951 balance sheet which reflected plant and machinery at their June 30, 1950 appraised values.[6]

Since the corporation has been operating at a profit in 1951,[7] the book value of the common stock and, *a fortiori*, the amount of the diversion, has increased.

To this $1,000,000 bonus must be added the other benefits which the Messrs. Sachs have reaped from this reorganiza-

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[4] If the stockholders fail to subscribe to all the 400,000 shares to be offered to them, the percentage interest of the Messrs. Sachs becomes proportionately larger.

[5] Calculated as follows:

Present stock outstanding	1,200,000 shs.
Stock to be issued to present stockholders @ $1.00 per share	400,000 "
Stock to be issued to Messrs. Sachs @ $.25 per share	400,000 "
Total shares to be outstanding (before option)	2,000,000 "
Per cent to be owned by Messrs. Sachs (400,000 divided by 2,000,000)	20%
Additional shares issuable against option	350,000 "
Total shares to be outstanding if option is exercised	2,350,000 "
Per cent to be owned by Messrs. Sachs (after option) (750,000 divided by 2,350,000)	31.9%

[6]

The balance sheet at January 23, 1951 showed a total capital of	$4,627,000
Add proceeds of 400,000 shs. of stock to be sold to present stockholders at $1.00 per share ($400,000) and 400,000 shs. of stock to be sold to Messrs. Sachs at 25¢ per share ($100,000)	500,000
Capital after giving effect to plan but before providing for exercise of option on 350,000 shs. by Messrs. Sachs	$5,127,000
Value per share (5,127,000 divided by 2,000,000 shs.)	$2.5635
Value of 400,000 shs. of Messrs. Sachs (400,000 times $2.5635)	$1,025,400

[7] For the 6 months ending June 3, 1951, the corporation had a profit of $40,349.41. This profit appeared in financial information submitted to the District Court at the time of the hearing on confirmation.

tion. By the option they are given a riskless "call," good for 4½ years, on part of the values in existence at the date of confirming and an opportunity to capture thereby almost 12% of all future profits.

Additionally, the Messrs. Sachs are to receive large compensation, by way of salary and a profit-sharing arrangement. The plan provided that the Messrs. Sachs would be given a 5-year contract with Waltham, "such employment to be upon such terms as may be approved by the Court prior to the confirmation of the plan" (Plan 15). The terms were not submitted to stockholders but at the hearing on confirmation, it was announced that Mr. Teviah Sachs is to be given a salary of $30,000 per year and, in addition, 6% of the net earnings after taxes, not to exceed $60,000. Mr. Gilbert Sachs is to be given a basic salary of $12,000 per year and, in addition, 4% of the net earnings after taxes, not to exceed $40,000. In short, Mr. Teviah Sachs has a salary ceiling of $90,000; Mr. Gilbert Sachs a ceiling of $52,000. Both salaries are a handsome increase over previous levels.

Finally, in addition to these tangible rewards, the Messrs. Sachs, by virtue of their 20% or 31.9% equity interest, will have a permanent hold over the destinies of Waltham. The common stock is widely held, chiefly in small blocks, and the Messrs. Sachs will have actual voting control.

C. Genesis of the Plan.

The present reorganization is the second within a period of two years. On December 28, 1948, Waltham Watch filed a petition for reorganization under Chapter X. The present trustees were appointed, and a plan of reorganization was effected. This plan was confirmed on June 10, 1949 and was consummated September 23, 1949 (226). Mr. Teviah Sachs entered the employ of Waltham in August 1949, just prior to the confirmation of this first plan (254). Mr. Teviah Sachs was employed as sales manager, under a two-year contract providing for a fixed salary of $25,000 (82; 130). In addition, Mr. Teviah Sachs was to be given a bonus at the discretion of the directors (82). Mr. Gilbert Sachs was

thereafter employed as a salesman at a lesser salary (69; 81-82). The Messrs. Sachs did not have the benefit of any stock purchase, option or profit percentage arrangements.

On February 3, 1950, Waltham filed a second petition for reorganization, thus initiating the present proceeding (228). The necessity for petitioning for reorganization resulted from a $4,000,000 loan which Waltham had received from the Reconstruction Finance Corporation as part of the plan consummated in the first reorganization. This loan was secured by practically all the assets of Waltham, and when the company was unable to meet its obligations under the loan, the R.F.C. declared the entire loan in default and took possession of virtually all assets. The plant was closed. The market price for the stock of Waltham plunged to pennies per share (228).

On February 28, 1950 the District Court approved the petition for second reorganization. The trustees who had served in the first proceeding were reappointed (203).

Several plans of reorganization were submitted to the District Court. The Messrs. Sachs presented their own plan to the trustees, which plan the trustees adopted and submitted to the Court on May 15, 1950. This plan, in material part, provided that Mr. Teviah Sachs (who later stated he was acting also on behalf of Mr. Gilbert Sachs) was to pay $100,000 for new preferred stock entitled to $100,000 on liquidation, and enough common stock to equal one-fourth of the outstanding common stock was to be thrown in. The company at the end of the first year in which it had net earnings of at least $100,000 was also obliged to sell to Mr. Sachs for $200,000, preferred stock entitled to $200,000 on liquidation, and to throw in therewith enough common stock to make Mr. Sachs' total holdings one-third of the outstanding common stock (231-234).

The Court on June 30, 1950 approved the plan. The Securities and Exchange Commission, to which the plan had been submitted for an advisory opinion pursuant to Section 172, 11 U. S. C. § 572, did not report.

The District Court approval of the Sachs plan occurred when the fortunes of Waltham were at their nadir. The Court said in approving the plan:

> **"The Waltham Watch Company is a solvent concern with a very heavy inventory, but is unable to do business because of the lack of capital. It has somewhere in the vicinity of $500,000 in cash in local banks in a blocked account under the control of the Reconstruction Finance Corporation. Its heavy inventory must be liquidated whether there is a reorganization or not. This inventory has been estimated as being valued at between $3,000,000 and $4,000,000." (130-1).**
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> * * * * *
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> **"None of the plans submitted, including the Trustees' plan, has any guarantee of success, but permanent success could be assured if the Reconstruction Finance Corporation will release the blocked cash account to the Trustees." (132).**

After the approval of the Sachs plan, a dramatic improvement occurred both in the legal and economic situation of the corporation.

On July 10, 1950 the District Court ordered the R.F.C. to turn over the corporate assets to the trustees. The R.F.C. appealed from this order, which the Court of Appeals affirmed on December 21, 1950. *R.F.C.* v. *Kaplan,* 185 F. 2d 791 (1st Cir. 1950). A stay pending the appeal having been denied, the trustees were at last in a position to sell the inventory.

The R.F.C., however, refused to turn over the $500,000 in its possession, and such cash was required to process the inventory. Mr. Teviah Sachs, who by this time had entered the company's employ, lent the company $50,000 against trustees' certificates, payable in four months from issue in priority to all debts. Contemporaneously, customers of Waltham also advanced $600,000 against open orders, also on the security of trustees' certificates. Thereafter, the uncompleted watches in inventory were processed and sold, and a net cash recovery of $2,600,000 resulted.

As a result of the decision of the Court of Appeals and the result of the inventory sale, an agreement was reached with the R.F.C. on January 18, 1951. This agreement provided for a reduction of the R.F.C. loan to $1,500,000 by July 1, 1951. Payment of the reduced balance was voluntarily extended to December 31, 1960 with interest and amortization payments of $10,000 to be made monthly. Thus, by January 18, 1951 the legal status was transformed from the desperate condition of June 1950 to one very favorable for Waltham (247A). The difficulties with the R.F.C. which had necessitated the reorganization were completely resolved. The company was now on its feet again. In addition, business from defense agencies suddenly rose to unexpectedly high levels following the Korean invasion in June 1950. The amount of this new source of revenue has not been revealed, but it is "substantial" (81).

By January 23, 1951, Waltham was completely solvent in all senses. It had no need for the sale of the preferred stock contemplated in the plan which had been approved. The plan was therefore modified on April 16, 1951 (215 *et seq.*). The essential feature of this modification was the elimination of the sale of the preferred stock to the Messrs. Sachs. In lieu of preferred stock, however, the Messrs. Sachs were given the option.

Despite the extraordinary difference in the legal and business conditions between the dates that the plan was originally formulated and approved and the date that it was proposed to be amended, no new plans were solicited and no new hearings were held. On May 1, 1951, the District Court approved the amended plan, stating "Essentially, however, it is the same" as the 1950 plan (38). The S.E.C., to which the amended plan was submitted, again filed no advisory report.

D. Confirmation of Plan.

Following approval of the amended plan, the votes of stockholders were solicited. Of the 1,200,000 shares outstanding, only a minority—410,759 shares—voted. Of those

voting 401,618 shares assented and 9,141 shares opposed (86).

On July 27, 1951, a hearing was held on confirmation of the plan (67-91). The present petitioners and the Protective Committee for Voting Trust Certificate Holders appeared and presented objections (72). The objectors made an offer to purchase 150,000 shares for $150,000 in cash—that is for $50,000 more than the Messrs. Sachs are to give for 400,000 shares (91-2). The attorney for the objectors stated:

> "We have tendered in court this morning an offer for 150,000 shares, $150,000 firm. If reasonable time is granted, we believe we could produce $400,000 at a minimum for these 400,000 shares [i.e., the 400,000 shares being sold to the Messrs. Sachs at $100,000]" (88).

The District Court said as to the petitioners' offer "It distinctly does not have the Court's approval" (73).

The plan was confirmed at 11:29 A.M. on the same morning that the hearing was held (94). On appeal the First Circuit affirmed the order of confirmation (265).

Reason for Granting the Writ.

1. The decision of the Court of Appeals is probably in conflict with the decision by this Court in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106 (1939). The conflict exists in two separate aspects:

a. *The Rule of Strict Priority:* Since *Northern Pacific R. Co.* v. *Boyd*, 228 U. S. 482 (1913), the rule of strict priority has governed bankruptcy reorganization proceedings. Any remaining doubts were explicitly laid to rest by the decision in the 1939 October Term in *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106 (1939). In *S.E.C.* v. *United States Realty & Improvement Co.*, 310 U. S. 434 (1940), as

well as in later decisions,[8] it was firmly established that for a plan of reorganization to be fair and equitable each class must be made whole before any subordinate class could participate.

This principle is violated by the present plan. "The stockholder interest is no doubt senior to that of Sachs" said the Court of Appeals (282); yet part of the stockholders' equity is being transferred to the Sachses. 400,000 shares of stock, which, depending on the figure used, have a value of anywhere from $2.80 a share to $1.83 a share,[9] are being sold for 25 cents a share. This diversion, this dilution, exists in fact. To say, as the Court of Appeals did, that in approving the plan, "it must have been the judgment of the stockholders * * * that this proposed acquisition of common stock by Sachs would not dilute the value of the existing stockholder interest" (283) is to ignore fact. Whatever the stockholders may have believed, their interest is nevertheless diluted when part of the equity is sold at anywhere from 1/11 to 1/7 of its book value. Only if the stockholders were receiving "a contribution in money or in money's worth," *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, 122 (1939); *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510, 529, n. 27 (1941); *Marine Harbor Properties, Inc.* v. *Manufacturers Trust Co.*, 317 U. S. 78, 85 (1942), would there be no dilution. No proof was offered to establish any value for the future services.

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[8] *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510 (1941); *Ecker* v. *Western P. R. Co.*, 318 U. S. 448 (1943); *Group of Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U. S. 523 (1943); *Otis & Co.* v. *S.E.C.*, 323 U. S. 624, 634 (1945); *R.F.C.* v. *Denver & Rio Grande W. R. Co.*, 328 U. S. 495 (1946); *S.E.C.* v. *Central-Illinois Securities Corp.*, 338 U. S. 96, 130-131 (1949).

[9] According to the balance sheet furnished to the stockholders at the time they voted on the plan the book value of each share was $3.80. If 1,200,000 shares have a book value of $3.80 a share, the issued 400,000 additional shares would yield a book value of $2.80. A subsequent balance sheet, dated June 30, 1951 and produced at the hearing on confirmation, shows a book value of $2.44 a share based on a 1,200,000 share capitalization. (The principal reason for this discrepancy is that the balance sheet submitted to stockholders carries plant and equipment at $3,341,000 representing appraised values, whereas the June 30, 1951 balance sheet carries plant and equipment at $1,946,768.11.) With a book value of $2.44 a share for 1,200,000 shares, the issuance of 400,000 additional shares would yield a book value of $1.83.

The Court of Appeals believed that insuring "continuance of the able management of Sachs" (283) was justification for the 25 cents sale. The bargain sale is sustained despite —or perhaps because—the fact that the value of the Sachs' management is "a matter of forecast based upon imponderable factors." But the *Case* decision expressly and wisely forbids the awarding of equity interests in return for such intangibles.

> "The findings below that participation by the old Class A stockholders will be beneficial to the bondholders because those stockholders have 'financial standing and influence in the community' and can provide a 'continuity of management' constitute no legal justification for issuance of new stock to them. Such items are illustrative of a host of intangibles which, if recognized as adequate consideration for issuance of stock to valueless junior interests, would serve as easy evasions of the principle of full or absolute priority of Northern P. R. Co. v. Boyd, 228 U. S. 482, 57 L. ed. 931, 33 S. Ct. 554, *supra*, and related cases. Such items, on facts present here, are not considerations for issuance of the stock in question. On the facts of this case they cannot possibly be translated into money, worth reasonably equivalent to the participation accorded the old stockholders."
>
> 308 U. S. at 122-123.

Accord:

> *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510, 529, n. 27 (1941).

See also:

> 6 Collier on Bankruptcy (14th ed.), par. 11.06.

Only in an ambiguous quotation found in a footnote in the *Case* opinion did the court below find authority for the proposition that management may be given stock interests to insure their continuance in office. Whatever that footnote may mean it surely does not so destroy the strict priority rule so

as to condone the gigantic benefits [10] being obtained by the Messrs. Sachs at the expense of the stockholders.

Even under Section 77B, a court stated, "We have been referred to no case where stock has been permitted to be issued 'without the shadow of right or consideration' and where it 'does not represent actual or substituted value in corporate assets.'" *Brockett* v. *Winkle Terra Cotta Co.*, 81 F. 2d 949, 959 (8th Cir. 1936). That missing authority is now furnished by the decision below.

Contribution to reorganization justifies award of administrative compensation; it is not a warrant to ignore the strict priority doctrine.

b. *The Vote of Stockholders:* The Court of Appeals placed heavy weight on the fact that the stockholders had assented to the plan—though to be sure such assent was by only a plurality of the interested parties. The opinion speaks of "the predominant judgment of the stockholders interested" (281), of "the judgment of the stockholders, in approving the plan" (283), and of the "considerable weight * * * [to] be given to the collective judgment of the stockholder group" "in determining the fairness of the plan in this respect" (279).

In thus giving weight to the assent by stockholders in determining the fairness and equitableness of the plan, the Court of Appeals was in direct conflict with the decision of this Court in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 114-115 (1939), as well as in conflict with decisions by other Courts of Appeals. *In re Waern Building Corp.*, 145 F. 2d 584, 589 (7th Cir. 1944); *In re Pure Penn Petroleum Co.*, 188 F. 2d 851, 856 (2d Cir. 1951). Whether a plan is fair and equitable is a purely legal issue unaffected in any way by the vote of the interested security holders. Even a

[10] In the event certiorari is granted, we shall contend that the option given to the Messrs. Sachs is a violation of the strict priority rule and is as well a provision beyond the bankruptcy power for it does not serve the rehabilitation of the corporation. It should be noted that when the stockholders approved the plan with this option provision, they did not know what salaries the Messrs. Sachs were to receive.

majority vote does not cure unfairness. In the *Case* decision Mr. Justice Douglas wrote:

> "The court is not merely a ministerial register of the vote of the several classes of security holders. All those interested in the estate are entitled to the court's protection. Accordingly the fact that the vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one. * * * The contrary conclusion in such cases would make the judicial determination on the issue of fairness a mere formality and would effectively destroy the function and the duty imposed by the Congress on the District Courts * * *. That function and duty are no less here than they are in equity receivership reorganizations, where the court said, 'Every important determination by the court in receivership proceedings calls for an informed, independent judgment.'"
>
> *Case* v. *Los Angeles Lumber Products*, 308 U. S. 106, 114-115 (1939).

2. The decision of the Court of Appeals is in conflict with the decision by the Court of Appeals for the Second Circuit in *Knight* v. *Wertheim & Co.*, 158 F. 2d 838 (2d Cir. 1947), cert. denied 331 U. S. 819 (1947).

An outsider acquires no vested interest in the assets by promulgating a plan which is unfair at confirmation date, albeit it was originally adequate.

In the *Knight* case the Court of Appeals laid down the rule that even after confirmation, providing prior security holders are fully protected, there is "no party to the reorganization whose interest the judge could properly weigh against that of the shareholders * * *" (at p. 843). In the *Knight* case where an offer favorable to stockholders was made, the Second Circuit directed the District Court to consider it though it was made *after* confirmation.

In the case at bar the First Circuit did weigh the interest of other parties against that of stockholders. It held that unless the commitment made to the Messrs. Sachs in 1950 was upheld despite "the greatly improved prospects of the

company" at the time of confirmation, "there would be little or no incentive for persons to come forward with long-chance commitments in aid of a corporate reorganization when the outlook is cloudy and uncertain, if the very success of the venture is taken as ground for denying its fruits to the one who is willing to make the speculation" (280-1). It cited for this proposition *Morrison* v. *Burnette*, 154 Fed. 617, 625 (8th Cir. 1907), a case expressly held by the *Knight* decision as not applicable to "a plan of reorganization." 158 F. 2d at 843-4. In stark contrast with the above quotation from the First Circuit opinion the language of the Second Circuit is:

> "Next as to that delay and as to the fact that the plan had been confirmed. We recognize that, except upon the extremest provocation, courts will not upset a judicial sale at auction, upon the ground that a new bidder has appeared who offers more than the knock-down price. Morrison v. Burnette, In re Burr Manufacturing & Supply Co., Currin v. Nourse. This unwillingness results from the effect upon such sales of knowing that a prospective bidder may abstain from bidding at the auction, may bide his time, and may then outbid the price at which the property has been struck down. That possibility tends to chill bidding at the sale, to dispose of the property by later competition on successive bids, and thus to defeat the very purpose of an auction, which is to fetch together all those who may be interested to buy and to set them against each other with whatever stimulus that may provide, as opposed to other kinds of sale. *None of this applies to a plan of reorganization.*" (pp. 843-44). (Emphasis added.)

In the *Knight* case, the Court of Appeals told the District Court to consider an offer favorable to stockholders made after confirmation; in the case at bar, though an offer before confirmation was made to buy 150,000 shares of stock for $50,000 more than the Sachses are offering for 400,000, the Court of Appeals sustained the District Court's refusal to consider the offer. The cases are in conflict both in principle and in practical result.

The *Knight* case is another example of the policy of *Rogers* v. *Hill*, 289 U. S. 582, at pp. 590-592 (1933). The Congressional purpose mandates the doctrine of the *Knight* case. H. R. Rep. No. 1409, 75th Cong., 1st Sess. 47 (1937).

3. The Court of Appeals has decided an important question of federal law which has not been but should be settled by this Court.

This Court has never had occasion to pass upon the fairness and equitableness of a plan of reorganization under Chapter X.[11] In the case at bar not only are there serious questions whether the plan conforms with the statutory requirements of fairness and equitableness as defined by this Court in its decisions under Sections 77 and 77B, but there is a further issue whether the reorganization should not have been dismissed.

Waltham is solvent—both in the equity and bankruptcy senses. The plan of reorganization affects no creditors' rights. Unsecured creditors are being paid off in full, and the agreement with the R.F.C. was reached before the amended plan of reorganization was approved. No rights of security holders *inter sese* are being adjudicated or modified; there is only one class of outstanding securities—common stock. The plan accomplishes no purposes except transfer to

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[11] In the following cases this Court has dealt with specific problems which were raised by Chapter X proceedings. *Dickinson Industrial Site* v. *Cowan*, 309 U. S. 328 (1940) (applicability of appeal provisions of Chapter X to appeal after its effective date); *R.F.C.* v. *Prudence Securities Advisory Group*, 311 U. S. 579 (1941) (appeals from compensation orders under Chapter X); *Woods* v. *City Nat. Bank & T. Co.*, 312 U. S. 262 (1941) (allowance of compensation under Chapter X); *Marine Harbor Properties, Inc.* v. *Manufacturers Trust Co.*, 317 U. S. 78 (1942) (filing of a petition in good faith); *Fidelity Assurance Association* v. *Sims*, 318 U. S. 608 (1943) (filing of a petition in good faith); *Brown* v. *Gerdes*, 321 U. S. 178 (1944) (power of state court to fix fees); *Price* v. *Gurney*, 324 U. S. 100 (1945) (right of stockholder to file derivative petition); *Young* v. *Higbee*, 324 U. S. 204 (1945) (accountability of stockholders who dismissed appeal from order of confirmation); *Finn* v. *Meighan*, 325 U. S. 300 (1945) (termination of lease); *Duggan* v. *Sansberry*, 327 U. S. 499 (1946) (conflict of jurisdiction between District Courts); *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156 (1946) (interest on interest); *Williams* v. *Austrian*, 331 U. S. 642 (1947) (federal jurisdiction of suit by trustees); *Leiman* v. *Guttman*, 336 U. S. 1 (1949) (jurisdiction over compensation for services to committee); *Mosser* v. *Darrow*, 341 U. S. 267 (1951) (liability of trustee for employees' trading profits).

the Messrs. Sachs; it cannot be contended that the plan is needed to obtain working capital, for petitioners' proposal which would have secured at least $50,000 more capital for the issuance of 250,000 less shares was rejected. The only other significant provision of the plan—the offer of 400,000 shares of common stock to the present stockholders—could be accomplished without reorganization.

The Court of Appeals refused to say whether the reorganization should have been dismissed; it did not even suggest that an exercise of discretion by the District Court was involved. Its only answer to our contention was that it was proper to continue the proceeding because "the debtor, the voting trustee of the common stock, and a protective committee representing the great majority in interest of the voting trust certificate holders did not want the proceeding dismissed" (278).

Continuance of a corporate reorganization should not depend upon the consent of the parties who happen to be before the court. Whether a reorganization should be continued is a matter for the court to decide, see *Chase* v. *Austrian*, 189 F. 2d 555, 557 (4th Cir. 1951), cert. denied 341 U. S. 952 (1951), not for the parties. Reorganization by consent has been abolished, *cf. New England Coal & Coke Co.* v. *Rutland R. Co.*, 143 F. 2d 179 (2d Cir. 1944).

Where a plan, as at bar, does not serve the rehabilitation of the corporation and all creditors are being satisfied the proceeding should be dismissed:

> "We think that in a case where all creditors have been eliminated so that the real objects of the statute have been satisfied, it is useless and hence unnecessary to have the proposed plan considered when neither it nor any substitute could properly be adopted."
>
> *Sword S.S. Line* v. *Vendramis*, 116 F. 2d 665, 668 (2d Cir. 1940).

It could only be under the most exceptional circumstances, if ever, that the affairs of a completely solvent corporation should be run not by its stockholders and their elected di-

rectors but by the decrees of a reorganization court. Here the court's influence not only continued throughout the reorganization but, by virtue of the plan, permanent control has been invested in the court's appointees, the Messrs. Sachs. If the corporation had not been under judicial aegis it is inconceivable that the stockholders would have voted away 20% to 31.9% of their equity to persons affiliated with the corporation less than two years.

CONCLUSION.

It is submitted that this case is one calling for the exercise by this Court of its supervisory powers by writ of certiorari.

Respectfully submitted,

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APPENDIX.

Section 172 of the Bankruptcy Act, 11 U. S. C. § 572, provides:

> "After the hearing, as provided in section 569 or section 570 of this title, and before the approval of any plan, as provided in section 574 of this title, the judge may, if the scheduled indebtedness of the debtor does not exceed $3,000,000, and shall, if such indebtedness exceeds $3,000,000, submit to the Securities and Exchange Commission for examination and report the plan or plans which the judge regards as worthy of consideration. Such report shall be advisory only."

Section 173 of the Bankruptcy Act, 11 U. S. C. § 573, provides:

> "The judge shall not enter an order approving a plan submitted to the Securities and Exchange Commission until after the Securities and Exchange Commission has filed its report thereon or has notified the judge that it will not file a report, or until the expiration of such reasonable time for the filing of such report as the judge has fixed, whichever first occurs."

Section 174 of the Bankruptcy Act, 11 U. S. C. § 574, provides:

> "After the hearing, as provided in section 569 or section 570 of this title, and, if a plan has been submitted to the Securities and Exchange Commission, as provided in section 572 of this title, then after the filing of the report or notice that it will not be filed, or after the expiration of the time for its filing, whichever first occurs, the judge shall enter an order approving the plan or plans which in his opinion comply with the provisions of section 616 of this title, and which are fair and equitable, and feasible, and shall fix a time within which the creditors and stockholders affected thereby may accept the same."

Section 221 of the Bankruptcy Act, 11 U. S. C. § 621, provides:

> "The judge shall confirm a plan if satisfied that—
>
> (1) the provisions of subchapter VII, section 599, and subchapter X of this chapter have been complied with;
>
> (2) the plan is fair and equitable, and feasible;
>
> (3) the proposal of the plan and its acceptance are in good faith and have not been made or procured by means or promises forbidden by this title;
>
> (4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge; and
>
> (5) the identity, qualifications, and affiliations of the persons who are to be directors or officers, or voting trustees, if any, upon the consummation of the plan, have been fully disclosed, and that the appointment of such persons to such offices, or their continuance therein, is equitable, compatible with the interests of the creditors and stockholders and consistent with public policy."

Index

	PAGE
Statement	1
Decision of Court of Appeals	8
Comment on Petitioners' Statement	10
Outline of Argument	11
Argument	12
1. The decision of the Court of Appeals is not in conflict with any decision of the Supreme Court.	12
2. The decision herein of the Court of Appeals for the First Circuit is not in conflict with the decisions of any other Courts of Appeal	16
3. No important question of federal law is presented herein which has not been but should be settled by this Court	18
4. The decision of the Court of Appeals was right	19
5. There are weighty reasons against the grant of the writ	19
Conclusion	21

TABLE OF AUTHORITIES

CASES

PAGE

In re A. C. Hotel Co., 93 F2d 841 (7th Cir. 1937)..14, 15
Case v. *Los Angeles Lumber Products Co.*, 308 U. S. 106 (1939) 8, 12, 18
Chase et al. v. *Austrian et al.*, 189 F2d 555 (4th Cir. 1951)..... 19
Clamitz v. *Thatcher Mfg. Co. et al.*, 158 F2d 687 (2d Cir. 1947).....16, 17
Consolidated Rock Products Co. et al. v. *DuBois*, 312 U. S. 510 (1941).....11, 18
In re Davis Boiler Works, 38 F. Supp. 701 (D.N.J. 1941) 13
Ewen v. *Peoria and Eastern Ry.*, 34F. Supp. 332 (S.D.N.Y. 1940)..... 13
Group of Investors v. *Milwaukee Ry.* 318 U. S. 523 (1943)..... 13
Insurance Group Committee et al. v. *Denver and Rio Grande Western Ry.*, 329 U. S. 607 (1947)..... 16
Jameson et al. v. *Guaranty Trust Co. of New York et al.*, 20 F2d 808 (7th Cir. 1927)..... 14
Kansas City Terminal Ry. v. *Central Union Trust Co.*, 271 U. S. 445 (1926)..... 12
Knight et al v. *Wertheim and Co., et al.*, 158 F2d 838 (2d Cir. 1946)..... 16
In re Lehigh Valley Ry., 34 F. Supp. 753 (E.D.Pa. 1940)..... 13
Morrison v. *Burnette*, 154 Fed. 617 (8th Cir. 1907).. 17
In re National Realty Trust, 166 F2d 632 (7th Cir. 1948)..... 19
Northern Pacific Ry. v. *Boyd*, 228 U. S. 482 (1913)... 12
In re Prima Co., 88 F 2d 785 (2d Cir. 1937)..... 21
In re Pure Penn Petroleum Co., 188 F2d 851 (2d Cir. 1951)..... 14

TABLE OF AUTHORITIES

CASES

PAGE

In re A. C. Hotel Co., 93 F2d 841 (7th Cir. 1937)..14, 15
Case v. *Los Angeles Lumber Products Co.*, 308 U. S. 106 (1939) 8, 12, 18
Chase et al. v. *Austrian et al.*, 189 F2d 555 (4th Cir. 1951)..... 19
Clamitz v. *Thatcher Mfg. Co. et al.*, 158 F2d 687 (2d Cir. 1947).....16, 17
Consolidated Rock Products Co. et al. v. *DuBois*, 312 U. S. 510 (1941).....11, 18
In re Davis Boiler Works, 38 F. Supp. 701 (D.N.J. 1941) 13
Ewen v. *Peoria and Eastern Ry.*, 34F. Supp. 332 (S.D.N.Y. 1940)..... 13
Group of Investors v. *Milwaukee Ry.* 318 U. S. 523 (1943)..... 13
Insurance Group Committee et al. v. *Denver and Rio Grande Western Ry.*, 329 U. S. 607 (1947)..... 16
Jameson et al. v. *Guaranty Trust Co. of New York et al.*, 20 F2d 808 (7th Cir. 1927)..... 14
Kansas City Terminal Ry. v. *Central Union Trust Co.*, 271 U. S. 445 (1926)..... 12
Knight et al v. *Wertheim and Co., et al.*, 158 F2d 838 (2d Cir. 1946)..... 16
In re Lehigh Valley Ry., 34 F. Supp. 753 (E.D.Pa. 1940)..... 13
Morrison v. *Burnette*, 154 Fed. 617 (8th Cir. 1907).. 17
In re National Realty Trust, 166 F2d 632 (7th Cir. 1948)..... 19
Northern Pacific Ry. v. *Boyd*, 228 U. S. 482 (1913)... 12
In re Prima Co., 88 F 2d 785 (2d Cir. 1937)..... 21
In re Pure Penn Petroleum Co., 188 F2d 851 (2d Cir. 1951)..... 14

PAGE

In re Quaker City Cold Storage Co., 71F. Supp. 124 (E.D.Pa. 1947) 14

RFC et al. v. *Denver and Rio Grande Western Ry.*, 328 U. S. 495 (1946) 16

Rogers v. *Hill et al.*, 289 U. S. 582 (1933) 14

In re Waern Building Corp., 145 F2d 584 (7th Cir. 1944) 14, 15

STATUTES

Chapter X of Bankruptcy Act (11 U.S.C. sec. 501) 1, 2, 8, 19

ARTICLES

Baker, *Stock Options for Executives*, 19 Harv. Bus. Rev. 106 (1940) 15

Bastedo, *Taxing Employees on Stock "Purchases"*, 41 Col. L. Rev. 239 (1941) 15

Dann, *Employee Stock Options Under H. R. 6712*, 37 Geo. L. J. 242 (1949) 15

Gardner, *Employee Stock Options*, 50 Mich. L. R. 409 (1952) 16

Washington, *Corporate Executives' Compensation* (1942) 16

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1951

No. 547

AL HOROWITZ, et al.
Petitioners

against

JACOB J. KAPLAN, et al. Trustees,
Respondents

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

STATEMENT

The statement of facts submitted by the petitioners is inaccurate and inadequate.

The facts are set forth in full in the opinion of the District Court (R. 25-40) and are recapitulated by the Court of Appeals in its opinion (R. 268-284). Briefly summarized they are as follows:

The Waltham Watch Company, hereinafter referred to as the Debtor, is a century-old company engaged in the manufacture and sale of timing instruments (R. 25) whose activities are essential to the defense of the United States (R. 26, 29). It had been reorganized on September 23, 1949 under a Chapter X proceeding (11 U. S. C § 501

and following) filed by it in December 1948 (R. 26). On February 3, 1950 it again faced a financial crisis and filed a second petition (R. 27, 28). Although the prospects of a successful reorganization appeared to be dim (R. 28, 270, 277), the District Court accepted the petition on February 28, 1950, in the belief that "there was a chance even though remote that the Company could be successfully reorganized" (R. 28), that the causes which led to the crisis were not irremediable (R. 29), and in the hope that the Debtor might be saved for its creditors, stockholders and the national defense, the latter particularly being emphasized by the Court in view of the war clouds which were already then apparently gathering (R. 29). The same Disinterested Trustees, who had served in the first reorganization, were prevailed upon to accept that office in these proceedings (R. 30). The Trustees were directed to make the necessary investigation and file the statement of information required by Chapter X (R. 126), to invite proposals for plans of reorganization, and to file a plan of reorganization by May 8, 1950 (R. 127).

The principal creditor of the Debtor was Reconstruction Finance Corporation (hereinafter referred to as RFC), which had in connection with the first reorganization loaned the Debtor $4,000,000 upon the security of mortgages, pledges and liens which encompassed substantially all of the Debtor's assets (R. 27, 28). RFC had declared this loan due and in default on February 3, 1950, and had taken possession of substantially all of the Debtor's assets including its plant, machinery and inventory (R. 28, 134). RFC already held possession under its liens of all of the Debtor's accounts receivable and about $500,000 in cash representing proceeds of these accounts, held by RFC as "collateral cash" (R. 30, 134, 131). RFC upon taking possession of the Debtor's plant, machinery and inventory had discharged the Debtor's working force, including all the trained makers of pre-

cision instruments, admittedly difficult to replace (R. 29), and refused to permit any manufacturing operations by the Debtor (R. 30). RFC was of the opinion that the Debtor's assets were worth less than the amount of RFC's net claim of $3,500,000 (R. 28, 30); that there was nothing available for unsecured creditors and therefore nothing for the Debtor's stockholders, who held voting trust certificates for about 1,200,000 shares of the Debtor's common stock (R. 46). The voting trust supporting these certificates had been set up as part of the first reorganization (R. 184, 185), and under its terms the duration of the trust was in the control of RFC (R. 194) who also controlled the designation of a majority of the three voting trustees (R. 190). Only one trustee has been in office during the proceedings herein (R. 46). RFC took the position that it would not continue its loan unless at least $2,000,000 was paid in for equity capital or $2,000,000 of RFC's loan was guaranteed (R. 30).

In the foregoing state of facts the Debtor's stock dropped in market value to "pennies per share" (Petition 7). The quotation in the week in which the petition was filed was 25¢ (R. 28). As of that time there was very serious question whether the stockholders had or could ever realize any value on their shares (R. 28, R. 30). There was obviously no hope for them unless (a) able management could be assured to take the Debtor out of the crisis, and to give it the necessary direction and care during its financial convalescence following a newly consummated reorganization (R. 27, 106, 136); (b) RFC, which represented 100% of the secured creditor class, could be placated (R. 30); (c) operations at the factory could be resumed and a threatened loss of $500,000 in a perishable inventory could be thus averted (R. 128) and, what was even more important, the permanent dispersal of the Debtor's valuable and practically irreplaceable labor force could be prevented (R. 29).

Four proposals for reorganization were submitted in May-June 1950 by various proponents (R. 31). One was submitted by the voting trustee for all of the Debtor's stock (R. 47); the other three by other proponents. The best of the latter three, so far as cash realization by the Debtor's stockholders was concerned, offered them 50 cents per share payable in market value of the stock of the proponent (another watch company), but this offer was for a 100% interest in the Debtor's stock, i.e., 50 cents per share was all the Debtor's stockholders could ever have realized based on the then current quotations of the proponent's shares (R. 33).

The proposal submitted by the voting trustee which was the basis of the Trustees' plan (R. 33, 47) was sponsored by the only committee for stockholders which had showed any activity in the matter (R. 46) until the appellants at the last moment appeared on the scene individually and by a committee in their behalf. The petitioners' committee had no other adherents excepting the appellants who held 510 shares out of a total of 1,200,000 — characterized by the Court of Appeals as "insignificant" holdings (R. 279).

The proposal of the voting trustee, who as such acted for all of the stockholders, in reliance upon which the plan subsequently confirmed herein was filed by the disinterested trustees (R. 47), was in turn based upon a committal by Teviah Sachs and his brother Gilbert Sachs (hereinafter collectively referred to as Sachs) (R. 33). The Sachs were experienced in the watch business (R. 75, 81). They had been associated with the Debtor as paid employees, but they held none of the Debtor's securities (R. 271). Sachs holding no securities and receiving no compensation, devoted himself to bringing about a reorganization of the Debtor (R. 271). He tried to get others to invest money, but without success (R. 78). Finally after all else had failed, "in sheer desperation" he

offered to enter into a five-year contract of management of the Debtor and to invest $100,000, which was substantially all the money he or his family had, in return for a one-quarter interest in the Debtor, and if the Debtor became financially profitable he agreed to invest another $200,000 for enough stock to bring his interest up to one-third (R. 34, 56, 57). His investment was to be represented partly in preferred stock and partly in common stock (R. 33). To support the foregoing, he executed a committal to invest the foregoing sums and to enter into the aforesaid employment (R. 57, 47, 56, 57). He proposed as part of the plan that pending consideration of the plan he be permitted to finish and sell the watch inventory with an assurance that RFC would thereby realize $2,000,000, i.e., one-half of its debt (R. 33). The plan proposed that the unpaid balance of RFC's loan be extended for a term of fifteen years secured only by the Debtor's fixed assets (R. 33). RFC would not consent to this plan (R. 30). RFC told Sachs that he was "throwing his [your] money down a sewer" and "that he [I] had a hole in his [my] head besides" (R. 85). Indeed RFC opposed all the plans proposed (R. 34), pressing on the contrary for leave to foreclose its liens, with the expectancy that this would leave nothing for either the unsecured creditors or the stockholders (R. 30, 85).

The District Court, expressing the opinion that liquidation of the Debtor's watch inventory had to be effected in any event (R. 35), finally on June 30, 1950 approved the Trustees' plan (R. 132), as the one which offered the stockholders the best opportunity to salvage their investment on the least expensive terms and one which insured to the stockholders the interest and incentive of Sachs to make this investment valuable (R. 33, 34). On July 10, 1950 the Court authorized the Trustees to employ Sachs, to take possession of the Debtor's plant, machinery and inventory and the collateral cash in RFC's possession and

process and sell the inventory which the Court found to be deteriorating and perishable because of its seasonal character, transferring RFC's lien to the proceeds of the sale (R. 128). RFC appealed from this order and tried unsuccessfully to have the order stayed pending the appeal (R. 273). The appeal was thereafter heard by the Court of Appeals for the First Circuit; and on Dec. 21, 1950 the order of the District Court was affirmed (RFC v. Kaplan, 185 F. 2d. 791). But processing and sale of the watch inventory could not wait for this decision without subjecting the Debtor to heavy losses (R. 128). RFC refused, pending the appeal, to turn over the collateral cash which was necessary for a working fund, although subjected to a fine for contempt for such refusal; and since at least $500,000 was necessary to process and sell the inventory, and the Trustees had no cash whatsoever, the Trustees were unable to move until Sachs came forward, and in order to advance the plan which had been approved by the Court and make its consummation feasible (a) advanced $50,000 of his own funds; (b) assembled an adequate working force; (c) obtained orders for $2,000,000 of watches payable in cash; (d) induced the customers to advance one-third of the amount of their orders before they had received a watch, thus assembling a working fund of more than $600,000; (e) processed and sold $3,200,000 of watches at a cash expenditure of $600,000; (f) thus enabling the Trustees to pay $2,000,000 and then $500,000 more to RFC on account of its debt as well as all of its charges for interest and principal (R. 36). Possession was in fact taken on September 12, 1950 (R. 36), the factory having been idle from February 3, 1950 until that date. As a result of the foregoing, RFC early in 1951 admitted that its judgment was wrong; it turned over the collateral cash fund to the Trustees, and agreed to extend the balance of $1,500,000 of its loan for about ten years, secured by the fixed assets (R. 36, 37).

The Trustees were then (February 27, 1951) enabled for the first time to present their plan to the security holders as one which was feasible (R. 36).

The plan which had been approved June 30, 1950 was, however, modified to reflect the agreement with RFC, and Sachs was induced to consent to receive an option for 350,000 shares at 95% of the then market of about $2.00 per share instead of his original committal to obtain 400,000 shares and preferred stock for a payment of $200,000 (R. 38). As the District Court points out, this would require Sachs to pay $500,000 more than his original committal in order to obtain slightly less than the one-third interest which he originally contemplated (R. 39).

The plan as amended was submitted to the security holders in May 1951. The consent of RFC was required, since the plan modified the voting trust. That consent was given (R. 92, 199). The consent of unsecured creditors was not required since they were to be paid in full promptly on consummation. The consent of a majority of the stockholders who proved their claims was required — and 97% of those so proving consented (R. 199). At the last moment the appellants who had theretofore taken no part in the proceedings (R. 210), and who in the aggregate held only 510 shares of the 1,200,000 outstanding (R. 266, 269) appeared at the hearing on confirmation and objected to the confirmation of the plan (R. 210, 277). The appellants conceded that there was no objection to the plan when it was first proposed and approved, that it was then fair and equitable (R. 279). They contended, however, that the affairs of the Debtor had so far improved (as was evidenced by a rise in the quotation of its stock from 25¢ per share when the petition was filed (R. 28) to $2.00 at the time of the hearing on confirmation (R. 88) and $3.00 at the time of the argument before the Court of Appeals) (R. 279) that the plan was now unfair

and inequitable and violated the absolute priority rule as appropriately reaffirmed by this Court in *Case* v. *Los Angeles Lumber Co.* 308 U. S. 106 (1938); and that the proceedings should be dismissed.

DECISION OF COURT OF APPEALS

The Court of Appeals filed an opinion in which upon the facts of the case as found by the District Court and recited by the Court of Appeals and as hereinabove summarized the Court of Appeals held:

1. Unless the plan is in conflict with some hard and fast rule of law, it is so clearly "fair, equitable and feasible" that the order of the District Court should be affirmed. The determination of the District Court which had complete familiarity with the facts will not be set aside unless clearly shown to be erroneous (R. 277).

2. Sachs came forward when the outlook was dim and discouraging with a plan which required immediate implementation to make it effective. "Because he had this faith in the company and was willing to back it up, the trustees were enabled to present to the court a feasible plan of reorganization, absent which the court presumably would have dismissed the Chapter X proceeding under § 236 of the Act, leaving RFC free to realize upon its security, in forced liquidation, with little or nothing left for the stockholders. Sachs, in other words, played a vital part in preserving the debtor's going concern value, to the aggrandizement of these appellants as well as the other stockholder interests" (R. 277, 278).

3. Dismissal of the proceedings was not required as a matter of law and was not in the best interests of the Debtor or of its security holders (R. 278).

4. In determining the fairness of the provisions of the plan as to the degree of participation of Sachs, if he was successful in saving the company from liquidation and the investment of the stockholders from destruction, con-

siderable weight should be given to the judgment of the voting trustee for all the stockholders and the overwhelming vote of those stockholders who had balloted on the plan (R. 278).

5. The fact that Sachs' efforts have succeeded should not now be taken as a reason for denying confirmation on the ground of changed conditions, for the very elements which have contributed to this success are those which were envisaged and hoped for when the plan was first approved in June 1950: "In the present case it is clear that the district court, when it initially approved the plan, anticipated that the successful liquidation of the heavy inventory, and the reduction of the RFC debt to a manageable amount, would remove the chief obstacle to the resumption of successful operations by the debtor after release from control of the bankruptcy court. The court was undoubtedly aware of the company's earning experience during World Wars I and II. Opportunity for profitable business from future conversion to defense production of precision instruments was regarded not only as a possibility, but was indeed a primary reason why the petition for reorganization had been approved by the district court. The greatly improved prospects of the company as of the date of the hearing on final confirmation of the plan came as no surprise to the district court, but was the hoped for result of the factors above mentioned. There would be little or no incentive for persons to come forward with long-chance commitments in aid of a corporate reorganization when the outlook is cloudy and uncertain, if the very success of the venture is taken as ground for denying its fruits to the one who is willing to make the speculation" (R. 280).

6. The absolute priority rule is not applicable here. Nothing is taken from the creditors or stockholders. On the contrary the efforts of Sachs in carrying out the plan and committing himself to a five-year employment made

a substantial contribution to the enhancement of the stockholders' equity (R. 282).

7. The incentive resulting from the option is desired by the great body of the stockholders and is an adequate consideration therefor (R. 284).

COMMENT ON PETITIONERS' STATEMENT

There is no foundation whatsoever for the statements in the petitioner's brief that a "gift of part of the equity of the common stockholders is being made to management" (Petition, 2); that "no creditors rights" are to be altered by the Plan (Petition, 3); that the "sole and simple purpose and result of the plan confirmed below is to grant to admitted 'outsiders' . . . a working control share of the stockholders' equity" (Petition, 3); that "this grant is made not in exchange for money or tangible money's worth but in gratitude for assistance of the outsiders in promulgating the present Plan" (Petition, 3); that "the plan invests outsiders with all the fruits of the reorganization" (Petition, 3); that "the sole effect of the plan is to dilute and redistribute the shares of the present shareholders in favor of the Messrs. Sachs" (Petition, 4); that the plan is that of Sachs (Petition, 7); that Sachs' efforts were not substantial factors in bringing about the dramatic improvement in the economic situation of the corporation which transformed the "desperate condition of June 1950 to one very favorable for" the Debtor (Petition, 9); that "gigantic benefits are being obtained by Sachs at the expense of the stockholders" (Petition, 13); that a commitment had been made to, rather than by, Sachs in 1950 (Petition, 14).

These wholly groundless claims are the foundation of the petition. It is only necessary to compare them with the facts as found by the Courts below to show that the claims of the petitioners are without substance.

It is true that what Sachs will get out of the plan has value, but (a) its amount will be measured not by the book value of the Debtor's assets which was the same when its shares were selling at 25¢ as when they were selling at $3; (b) nor will that value be determined by multiplying by 400,000 what a few shares may sell for on the stock exchange on a given day. The value will be measured by the prospects that the Debtor as reorganized will make net earnings; and if such value is found it will have been created by Sachs (cf. *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 526 (1941)). If further evidence of the value of the Sachs management is needed, it is found in the fact that for the first time after six years of staggering losses the Debtor under Sachs management has made net earnings in a fiscal period. True the net earnings were small (about 6 cents per share on an annual basis), but they are significant since they were net earnings and not net losses; and they were made by the company in reorganization after its plant had been completely shut down from February 3, 1950 to September 12, 1950. And whether Sachs employment contract does or does not yield him an increase over previous levels depends upon his ability to produce substantial net earnings for the Debtor to the advantage of the stockholders.

OUTLINE OF ARGUMENT

It is clear from the foregoing that there are no reasons supporting the granting of the petition, since as will be amplified hereinafter:

1. The decision of the Court of Appeals for the First Circuit is not in conflict with any decision of the Supreme Court.

2. The decision of the Court of Appeals for the First Circuit is not in conflict with the decisions of any other courts of appeal.

3. The case presents no new important questions of federal law which require resolution through a consideration of this case by the Supreme Court.

4. The decision of the Court of Appeals for the First Circuit is right.

5. There are weighty reasons why the petition should be dismissed and the reorganization permitted to proceed.

ARGUMENT

1. *The decision of the Court of Appeals is not in conflict with any decision of the Supreme Court.*

The appellants contend that the decision of the Court of Appeals is in conflict with the decisions of this Court of which *Case* v. *Los Angeles Lumber Co.* 308 U. S. 106 is typical in that:

a. It is claimed that the decision violates the absolute priority rule as stated in that case.

b. It is claimed that the decision of the Court of Appeals gave conclusive weight to the fact that there was an overwhelming majority vote in favor of the plan and only an insignificant number of shares opposed it.

There is nothing in either of these points.

a. It is clear, as the Court of Appeals points out, that this is not the kind of case envisaged by the Supreme Court in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106 (1938) carrying out the doctrine of the *Boyd* case. (*Northern Pacific R. R.* v. *Boyd* 228 U. S. 482 (1913).) Here nothing is taken from any creditor or security holder. Creditors receive payment in full; and stockholders have the value of their equity not merely intact but enhanced.

As the Supreme Court pointed out in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. at 117 quoting from its earlier decision in *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445, it is clear

that the rule of absolute priority does not "require the impossible" and "generally additional funds will be essential to the success of the undertaking. *In such or similar cases the chancellor may exercise an informed discretion concerning the practical adjustment of the several rights*" (italics supplied). Here it was not additional funds alone, but competent management that was also required. Sachs offered, procured and delivered both.

The foregoing conclusion is re-enforced by cases like *Group of Investors* v. *Milwaukee R. Co.*, 318 U. S. 523 (1943) in which the Supreme Court says at page 565, "It is sufficient that each security holder in the order of his priority receive from that which is available for the satisfaction of his claim the *equitable equivalent* of the rights surrendered. That requires a comparison of the new securities allotted to him with the old securities which he exchanges to determine whether the new are the equitable equivalent of the old. . . . *Whether in a given case senior creditors have been made whole or received full compensatory treatment rests in the informed judgment of the commission and the district court on consideration of all relevant facts*" (italics supplied).

See as illustrative cases:

Ewen v. *Peoria & Eastern Ry. Co.*, 34 F. Supp. 332 (S. D. N. Y. 1940).

Re Lehigh Valley R. Co., 34 F. Supp. 753, 759 (E. D. Pa. 1940).

Re Davis Boiler Works, 38 F. Supp. 701 (D. N. J. 1941).

b. It is obvious that the Court of Appeals gave no such conclusive weight to the overwhelmingly approving vote of the stockholders as is claimed by the appellants. The Court merely applied sound business judgment to what is essentially a business question, namely whether the composite judgment of the great body of stockholders who are those primarily concerned and who stand in the same position as the appellants believe is that they have

received a fair quid pro quo. This Court recognized the value of the evidence of that judgment in the case of *Rogers* v. *Hill*, 289 U. S. 582, cited by the appellants (Petition, p. 16) wherein this Court on the question of the validity of a large payment as compensation to a corporate officer at page 591 said: "Much weight is to be given to the action of the stockholders. . . ."

It is true that even the holder of a single share can object to an illegal plan even though the holders of 400,000 shares have assented. When, however, the question is not one of legality, but rather of the fairness and reasonableness, of a plan of reorganization, the fact that 401,618 shares assented to the plan, that only 9,141 shares voted against the plan, and that only 510 shares have claimed an appeal from the order confirming the plan is strong evidence of the fairness of the plan, and of the shareholders' satisfaction with the information supplied to them in connection therewith.

Jameson et al. v. *Guaranty Trust Co. of New York et al.*, 20 F. 2d. 808, 815, C. C. A., 7th (1927).

"While in such matters majorities do not govern, the approval thus signified by this vastly greater number, whose interests are identical in kind with those of the objectors, is entitled to much weight in determining whether or not the plan is equitable and fair."

Re Quaker City Cold Storage Co., 71 F. Supp. 124, 128 (E. D. Pa. 1947).

See also *Re A. C. Hotel Co.*, 93 F. 2d. 841 (C. C. A. 7, 1937).

The case of re *Pure Penn Petroleum Co.*, 188 F. 2d 851 (2nd Cir. 1951) and in re *Waern Building Corp.*, 145 F. 2d 584 (7th Cir. 1944) claimed by the petitioners to be decisions by Courts of Appeals in conflict on this aspect of the case with the decision by the Court of Appeals herein are not at all in conflict with that decision. An examination of these cases demonstrates that fact. In re *Pure Penn Petroleum Co.*, the attempted reorganization under

Chapter XI of the Bankruptcy Act was clearly invalid under the express requirements of that statute. No mere majority could make it valid. In re *Waern Building Corp.*, the language of the decision supports the decision of the Court of Appeals herein and the contentions of the respondents herein,— for the Court of Appeals for the 7th Circuit says at page 589:

> "But where the plan is not unfair or inequitable" [as a matter of law] "and the sole question is one of feasibility, the collective judgment of the bondholders, the parties primarily concerned should not be lightly thrust aside; in re *A. C. Hotel Co.* 7 Cir. 93 F 2d 841; in re *Gibson Hotels* D. C. 24 F. Supp. 859; and it is a relevant consideration that the overwhelming percentage of bondholders have voted to accept the plan."

Options for the purchase of stock as incentives are recognized as valuable instruments in promoting the interests of a corporation. When, as here, the option is granted at substantially the current market price, it can be of no value to the executive unless the market price of the stock rises substantially above its price at the time of the grant of the option. Hence, there is a powerful incentive to promote the interests of the business. Congress has recognized the value of this incentive by subjecting only to capital gains taxes the increment in value by the recently adopted 1950 amendment to the Revenue Code known as Section 130 A. For further discussion of the value of options as incentive, see:

Baker, *Stock Options for Executives,* 19 Harv. Bus. Rev. 106 (1940).

Bastedo, *Taxing Employees on Stock "Purchases,"* 41 Col. L. Rev. 239 (1941).

Dann, *Employee Stock Options Under H. R. 6712,* 37 Geo. L. J. 242 (1949).

Washington, *Corporate Executives' Compensation* (1942).

Gardner, *Employee Stock Options*, 50 Michigan L. Rev. 409 (1952). Note 4 at page 410.

2. *The decision herein of the Court of Appeals for the First Circuit is not in conflict with the decisions of any other Courts of Appeal.*

The appellants cite as the basis for this ground of their application the case of *Knight* v. *Wertheim & Co.*, 158 F. 2d. 838 (C. C. A. 2d. 1947) in which the Court of Appeals for the Second Circuit directed the District Court to re-examine a plan where the affairs of the Debtor had greatly improved following the initial approval of the plan. But as the Court of Appeals for the Second Circuit points out at several places in its decision (see pp. 843, 844), the reason for the improvement was a supervening event which could not have been envisaged when the original plan was confirmed. The contrary is true in the present case. As this Court has on several occasions stated, supervening changes are not grounds for refusing to give final approval to a plan when they are the very changes which the plan contemplates and upon which it was predicated.

RFC v. *Denver & Rio Grande Western R. R. Co.*, 328 U. S. 495, 521 (1946).

Insurance Group Committee v. *Denver & Rio Grande Western R. R. Co.*, 329 U. S. 607, 611 (1947).

Cf. also *Clamitz* v. *Thatcher Mfg. Co.*, 158 F. 2d. 687 (C. C. A. 2d. 1947).

In *RFC* v. *Denver & Rio Grande Western R. R. Co.*, 328 U. S. 495 (1946) the Supreme Court said at page 521 as quoted by the Court of Appeals (R. 280) a plan should not be set aside because of economic changes which "are of the kind that were envisaged and considered by that commission in its deliberations upon or explanations of the plan."

The Court of Appeals in its decision pointed out that the improvement in the Debtor's position, and the at-

tendant circumstances thereof, was indeed envisaged and was the hoped for result of the Plan and the interim operations thereunder (R. 280).

It is significant that the identical judges (L. Hand, A. Hand and Chase) who decided the case of *Knight* v. *Wertheim & Co.*, 158 F 2d, 838 (2d Cir. January 8, 1947) had less than 10 days earlier decided *Clamitz* v. *Thatcher Manufacturing Co.* 158 F. 2d 687 (2d Cir. Dec. 31, 1946) reported in the same volume of reports and cited at page 281 of the Record as an appropriate analogy by the Court of Appeals in its opinion in the case at bar along with *Morrison* v. *Burnette*, 154 F. 617 (C.C.A. 8th 1907). In *Clamitz* v. *Thatcher* the Court of Appeals for the 2d Circuit, dealing with a non-bankruptcy reorganization in which the market value of stock subject to options given to new management had risen sharply while the matter was in progress, and which in many respects, particularly the interim exertions of the reorganizers, bears a resemblance to the facts herein, said in 158 F. 2d at page 693:

"A new management had been installed with competent men in charge who were to be given every reasonable incentive to build up the corporation's earning capacity and it was thought essential to create the desire to cooperate on the part of some so-called key employees. Good morale would not be attained in the organization if those who had been led to expect they would receive options and who might reasonably believe that their willingness to cooperate had in part at least been responsible for the increase in the exchange price of the stock, were put in the position to feel that the corporation's own delay had been used to their disadvantage. Whether to disappoint the just expectations of those on whom the corporation needed to rely during its upbuilding was a business problem for the directors to solve. Having justifiably found that they did it in the manner heretofore stated by honestly exercising their

best judgment to promote the welfare of the corporation, the trial court rightly dismissed the plaintiff's complaint whose charges of fraud and waste remained to the end the unproved assertions of but one dissatisfied stockholder."

3. *No important question of federal law is presented herein which has not been but should be settled by this Court.*

Each reorganization presents of course a new set of facts. The fundamentals of a proper plan have been settled by this Court and applied in numerous decisions commencing with *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 100 (1939) and *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510 (1941) and including the numerous decisions cited by the petitioners in their brief (P. 16, note 11).

However, the petitioners say that this is a case in which the proceedings should have been dismissed when the settlement with RFC was effected, and the Debtor permitted to fend for itself, since it is said the Plan affects no creditors rights. This assertion is not correct. The Plan does provide an important modification in the rights of RFC through the proposed modification of the voting trust. Under the voting trust as established pursuant to the first plan, all of the Debtor's stock was held by three trustees in a voting trust (R. 184). This trust was by its terms to continue until RFC's debt was paid in full (i.e., 10 years or longer) unless RFC chose to terminate it at an earlier date (R. 194). One trustee was to be at all times a nominee of former Debenture Holders of the Debtor. The nomination of the other two, i.e., a majority was in the control of RFC (R. 190). Under the trustees' plan proposed herein (a) the term of the trust was limited to one year; (b) it was not terminable by RFC; (c) a majority of the trustees were designated under the plan without RFC approval; (d) vacancies would be filled by the Court (R. 54). These were important modifications of the

rights of the secured creditor (RFC) as well as of the rights of shareholders. The modifications were an essential part of the Plan and could not have been accomplished without a Plan consummated under Chapter X. RFC's assent was necessary, but RFC's assent alone would not have been effective to bring about the amendments without the use of Chapter X machinery.

Accordingly the alleged basis for the petitioner's argument that the proceedings should have been dismissed fails completely. No other "important federal question" is asserted.

This is of course quite apart from the proposition that Chapter X would have failed of its purpose if, its support having been effective to restore a Debtor to solvency, that support should be withdrawn with the imminent risk of plunging the Debtor into insolvency again.

Whether a Chapter X proceeding shall be dismissed because of improved conditions rests in the sound discretion of the court administering the proceedings.

Chase v. *Austrian*, 189 F. 2d. 555, 556 (4 Cir. 1951) cert. denied 341 U. S. 952.

Re National Realty Trust, 166 F. 2d. 632, 635 (7 Cir. 1948).

4. *The Decision of the Court of Appeals was right.*

No better argument can be presented to demonstrate the correctness of the decision of the Court of Appeals than its own opinion (R. 266).

5. *There are weighty reasons against the grant of the writ.*

Thus far the respondents herein have stated matter in negation of the petitioner's contentions. The record herein shows clearly that even if the Supreme Court were disposed for any of the reasons asserted by the petitioners to grant the writ, it ought not to do so, since further delay in consummating the plan and allowing the Debtor to manage its own affairs may well prove fatal to the Debtor and destroy all the good that has thus far been accomplished.

a. The plan provides as an essential prerequisite the raising of $400,000 by the sale of 400,000 shares to the existing stockholders at $1 per share. When the Plan was first proposed in June 1950 and the stock was selling at 50¢ per share, the prospect of a successful sale of this block of stock was so doubtful that the Plan provided for an underwriting, necessarily at a commission to the underwriters (R. 33). With the improved prospects of the Debtor, and the stock selling at $2, the need for an underwriting ceased to exist. But it was recognized that such need might recur, if the course of events should substantially reduce the market price of the stock, and underwriting was made optional in the discretion of the trustees (R. 40). It is clear, however, since the present market value of the stock is closely related to the course of world events, that there is a serious chance that if consummation of the plan is delayed that course may be such as to depress the market value of the stock. That is a chance which the Debtor can ill afford to take.

b. The record discloses that while the Debtor is now solvent, its available cash is at a minimum point. The Debtor should have been allowed to keep $500,000 more as long-term debt by RFC, but the latter was unwilling and the trustees made the best bargain they could (R. 31). RFC thought at one time that the Debtor needed $2,000,000 of equity capital (R. 30); and Bulova proposed to put in $1,400,000 of cash capital (R. 33). In the earlier reorganization the banks were so doubtful of their ability to recover $4,300,000 of secured obligations that they accepted a discount of $1,060,000 in order to obtain immediate cash payment of the balance of their claims (R. 26). Applying the immediately current RFC payments of $250,000 due July 1, 1951 to the Debtor's cash on June 30, 1951 (R. 181) leaves a narrow cash margin necessitating borrowing (R. 86). Such borrowing by trustees in reorganization is necessarily restricted and lacks the

freedom of conduct essential in the management of an active manufacturing enterprise of this kind (see Re Prima Co., 88 F. 2d. 785). The maintenance of the gains already made in the rehabilitation of the Debtor will require refinancing, not practicable while the status of the reorganization remains in doubt.

c. Persons who deal with the Debtor in reliance upon the Sachs management are obviously hesitant to make long-term commitments while the permanence of that management remains in doubt.

d. The appellants represent no public interest. The Securities and Exchange Commission (R. 34, 40) declined to comment on the plan. Unless some other reason appears, the only purpose which the appellants can have is to protect an investment of a few thousand dollars which has already been substantially increased in value by the Plan. To do this the appellants are following a course of conduct which may well cost their fellow stockholders the millions of dollars in market value which the efforts of Sachs in endeavoring to carry out the Plan have already brought to these stockholders. It is indeed worthy of note that the appellants appearing as they did at the last moment offered to pay only 50% of the then market price of the stock — and offered no management or plan for management (R. 73).

CONCLUSION

The petition presents no adequate reasons for granting a writ of certiorari. The decision of the Court of Appeals is not in conflict with any decision of the Supreme Court or of any other Court of Appeals which might justify the issuance of the writ, nor is any important question of federal law involved which requires decision. On the contrary the application would delay the carrying out of a

decision which is clearly right, and imperil the successful rehabilitation of the Debtor, thus not only endangering the investment of the stockholders of the Debtor who have overwhelmingly approved the plan, but also seriously weakening or perhaps destroying an important link in the national defense.

Respectfully submitted,

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JACOB J. KAPLAN
C. KEEFE HURLEY
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JACOB J. KAPLAN,
Attorney for Respondents.

FILED
FEB 14 1952
CHARLES ELMORE CROPL
CLE

Supreme Court of the United States.

OCTOBER TERM, 1951.

No. 547.

AL HOROWITZ ET AL.,
Petitioners,

against

JACOB J. KAPLAN ET AL., TRUSTEES,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

BRIEF IN OPPOSITION OF PROTECTIVE COMMITTEE FOR THE COMMON STOCKHOLDERS.

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for the Common Stockholders.

ADDISON C. GETCHELL & SON, LAW PRINTERS, BOSTON.

Supreme Court of the United States.

October Term, 1951.

No. 547.

AL HOROWITZ et al.,
Petitioners,
against
JACOB J. KAPLAN et al., Trustees,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit.

BRIEF IN OPPOSITION OF PROTECTIVE COMMITTEE FOR THE COMMON STOCKHOLDERS.

This Committee, of which Mr. William H. Hudson of Baltimore, Maryland, is chairman, represented the holders of debentures of Waltham Watch Company in the first reorganization of 1949. These debentures were transmuted into and now comprise over ninety per cent of the company's only equity securities—common stock represented by Voting Trust certificates. When a new crisis in the company's affairs arose in January, 1950, the Committee was again called upon to act. It is the only Committee representing stockholders recognized by the District Court. The existing voting trustees resigned in the emergency and

Mr. Hudson then became and remains the sole voting trustee.

The Committee and its counsel have remained constantly active in the interest of the stockholders, who have by an overwhelming vote approved the plan. It is inaccurate and misleading for the petitioners to say in their petition (p. 7) that "the Messrs. Sachs presented their own plan to the trustees, which plan the trustees adopted." The plan was originally formulated and presented by the voting trustee and the Stockholders' Committee (R. 33, 47). It resulted from intensive negotiation with Mr. Sachs and involved very important commitments by him (R. 47, 56, 57) as well as the incentive to him of which petitioners belatedly complain. It was subsequently modified to the substantial advantage of the stockholders as the prospects of the company improved under Mr. Sachs' management as agent for the trustees (R. 38, 39).

The petitioners conceded in their brief below that the plan was formulated and "proposed at a time when the outlook and condition of the debtor were desperate." They were so desperate that the District Judge found that the stockholders were faced with the total loss of their investment. Subsequent to its formulation, other plans were submitted. Of those, only one (that of Bulova) offered anything to the stockholders. It offered them Bulova stock having a market price far below the market price of their Waltham stock at the time when the accepted plan received the initial approval of the Court.

It is very cavalier of petitioners to say to this Court (p. 8) without elaboration that "customers of Waltham also advanced $600,000 against open orders." The solvency of the company turned upon the disposal of the frozen inventory, huge in size and largely unfinished. The procuring of this money, imperatively needed to finish and market this inventory, by a company in Waltham's situa-

tion was due to the trade's confidence in Mr. Sachs (R. 36). It was in part because of the belief that Mr. Sachs could accomplish this result that Mr. Hudson as voting trustee and Chairman of the Stockholders' Committee offered the plan to the trustees.

In short, in return for the incentive offered him by the plan, Mr. Sachs hazarded his effort, the money which he advanced to the trustees, and his good reputation in the watch industry. Had he not done so, the situation would not have been one of reorganization, but of forced liquidation. Moreover, Mr. Sachs undertook to mortgage his future to the company by his agreement to accept a five-year contract of full-time employment (R. 47, 56, 57).

The stockholders have now seen the market value of their stock sharply enhanced, the debt burden of the company greatly reduced, and their investment safeguarded by the assurance of competent management. They have exchanged a position of the bleakest character for one of apparently well-grounded hope despite the damage from which they are now suffering from the petitioners' prolongation of the uncertainties of the situation. The Committee was and remains convinced that the plan as finally submitted to the stockholders is not only fair to them but the best which the circumstances permitted. It believes that it fully deserved the approval which it has received from the stockholders, from the District Court, and from the Court of Appeals.

Of course the company's position has improved. But it did not result from "matters not foreseen," as in *Knight* v. *Wertheim & Co.*, 158 F. (2d) 838. This is true even of the relation of the company to the national emergency which has been emphasized from the beginning of the company's troubles (R. 29). The improvement resulted from the presentation of a feasible plan of reorganization and the steps taken in consonance therewith. Subsequent

to the beginning of the Korean hostilities the plan was, as has been said, modified by the trustees by substantially reducing the benefits to the Messrs. Sachs (R. 38, 39).

It may be added that no alternative to the accepted plan was presented to the Courts below by the petitioners. There was an offer to buy 150,000 shares at half the current market price and that is all there was.

Apart from the inevitable business handicap to the Waltham Watch Company imposed by the prolongation of litigation, there is a further serious consequence of delay in the consummation of the plan. The company badly needs for working capital the new money which is proposed to be raised by subscription to additional common stock —$100,000 from Messrs. Sachs and $400,000 from the old stockholders. The prompt termination of the litigation is plainly of great consequence to the stockholders.

The controlling legal objections to the granting of the present petition are set out in the brief of the respondent trustees. They need not be repeated here. This memorandum is directed primarily to the assumption implicit in the petitioners' brief that the plan is not fair to the stockholders. It is submitted that it is eminently fair and that the petition for certiorari should be denied.

Respectfully submitted,

PROTECTIVE COMMITTEE FOR THE COMMON STOCKHOLDERS,

By LaRue Brown,

Harold P. Seligson,

Its Attorneys.